

INCENTIVES MATTER

**CITIZEN'S FINANCE
REVIEW COMMITTEE**

February 18th, 2003

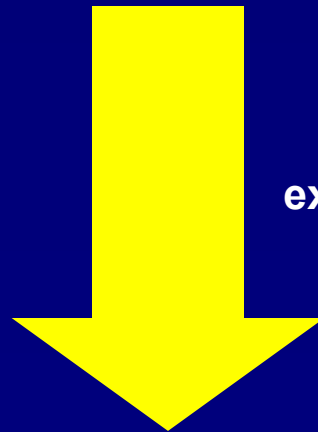
**Presented by:
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**How you tax will directly
impact your ability to obtain
and retain high quality base
industry jobs.**

Flow of the Region's Economy

Export Industries

Manufacturing, Tourism, Export-related Business Services, Retirement,
Luke AFB, Arizona State University



Spending by
export industries

Local Market Industries

Retail, Construction, Local Business Services, Banks, Government

“Export” or “Base” Industries

**Those industries where
demand for goods & services
comes from outside the region**

- **This creates demand for local
goods & services.**

“Local Market” or “Domestic Sector” Industries

- **These industries exist because of demand created within the local market**
- **What happens in these industries is a function of what happens to “export” or “base” sector industries.**

Examples of Export Industries

- Intel opens a fab plant
- A tourist comes to the region
- America West home office personnel
- A retiree lives here during winter
- ASU student from out of the region

Manufacturing

- **High-tech manufacturing**
 - **Motorola, Intel, Honeywell, Boeing, & others**
- **Non-high-tech manufacturing**
 - **Phelps Dodge, Simula, Ping, & others**

Tourism

- **America West home office**
- **Phoenician, Arizona Biltmore, Pointe at South Mountain, & others**

Business Services

Export-oriented business services help people outside the region.

- **Charles Schwab, Discover, American Express, JDA Software, Insight, & others**
- **Call centers**

Retirement

- Retirement-age people come to the region for the climate and to be close to family.
- They come here and spend money. Some live here part-time and others full-time.

Other Export Industries

- **Luke AFB**
- **Arizona State University (to the extent students from from outside the region)**

**These export industries drive
the region's economy.**

Ripple Effect

The creation of 100 jobs in electrical equipment with an average annual salary of \$82,000 results in:

- 56 indirect jobs @ \$49,400
- 103 induced jobs @ \$33,800

Total Jobs = 259

Ghost Town of Calico, California



See more Ghost Towns on:
GhostTownGallery.com

GHOST TOWNS

Economic Impact on the Region

- **ON Semiconductor pays a salary to its employees.**
- **The company buys goods & services within the region.**
- **This creates demand for local goods & services from within the region**

Economic Impact on the Region

- **ON employees spend their salaries on items such as:**
 - **House**
 - **Car from the Chevrolet dealer**
 - **Suit from Dillard's**
 - **Big Gulp from 7-Eleven**
 - **Plumber**
 - **Haircut**

Economic Impact on the Region

- **ON buys local goods & services such as:**
 - **Office supplies from Staples**
 - **Cleaning supplies from Wal-Mart**
 - **Office / industrial buildings**
 - **Air conditioner repairman**

Economic Impact on the Region

- In turn, employees at Dillard's and 7-Eleven receive salaries.
- They spend money on local goods & services.

Examples of Local Market Industries

Retail

Dillard's, 7-Eleven, car dealers

Construction

Homebuilding, office & industrial buildings, shopping centers

Local Business Services

Banks, insurance agents

In essence ...

The viability of any economy is a function of the prospects for its export-related industries.

Those export industries that create the highest wage jobs are generally in manufacturing, especially high-tech manufacturing.

High-tech services also create high-wage jobs.

**Thus, need to attract &
keep companies that are:**

- 1. In early stages of their life cycle.**
- 2. Have substantial growth possibilities**
- 3. Pay above average wages.**

When possible:

Tax the companies that are going to be here anyway and don't have direct out of state competition.

Be kind to those companies that can pick up and leave.

**Arizona is kind
to households
and tough on
business.**

While Arizona's overall and consumer tax burdens are competitive relative to the other states, the business tax burden is higher here than in competing states.

Aggregate Tax Burden

State & Local Taxes – National Rank

Source: Federal Tax Administrators

	Taxes as Percent of Personal Income	Ranking
ARIZONA	11.2%	22
California	12.0%	10
Colorado	NA	43
Idaho	11.5%	18
Nevada	10.5%	42
New Mexico	12.7%	6
Oregon	10.6%	40
Texas	9.7%	47
Utah	11.9%	12
Washington	10.8%	33

*Based on FY00 Taxes

Aggregate Tax Burden

State & Local Taxes – National Rank

Source: Federal Tax Administrators

	Taxes Per Capita	Ranking
ARIZONA	\$2,599	37
California	\$3,545	8
Colorado	\$3,073	19
Idaho	\$2,546	39
Nevada	\$2,915	24
New Mexico	\$2,639	34
Oregon	\$2,751	30
Texas	\$2,505	41
Utah	\$2,630	35
Washington	\$3,178	16

*Based on FY00 Taxes

Household v. Business Tax Burden

State & Local Taxes

Source: ASU

NATIONAL RANK

Household Taxes /
\$1,000
Personal
Income

Business Taxes /
\$1,000 of
Gross State
Product

ARIZONA

32

14

California

22

26

Colorado

36

39

Idaho

18

32

Nevada

17

42

New Mexico

9

23

Oregon

24

41

Texas

48

13

Utah

8

35

Washington

40

2

**Where is Arizona not
kind?**

**Personal Property Taxes
(Business Tax)**

**Important for High Tech
Manufacturing**

**An estimated 69% of
Arizona's business tax
burden is business property
taxes.**

“FISCAL POLICY”

The deliberate manipulation of taxes and government expenditures in order to provide services and affect the level of income and other economic variables.

“TAX POLICY”

**An element of fiscal policy that
manipulates taxes to achieve
some end.**

**We are not going to
decide what level of
overall taxation is
desirable.**

Ultimate Goals:

1. Limited but adequate taxation.
2. Limited but responsible spending.
3. Proper maintenance of reserves.

What to look for in a tax code:

- **Predictable**
- **Simple**
- **Does not significantly change behavior.**
- **Stable (well, to the extent possible)**
- **Competitive**
- **Developed to be fair, or to stimulate economic development?**

**Currently, the State has
no
real Fiscal Policy...**

**...and no consistent
Tax Policy**

WIDE DEBATE ON SPENDING LEVEL

***It is not the purview of this commission.**

Who Gets Taxed?

**Again, Arizona is
kind to
households and
tough on
business.**

Notable Taxes

(State & Local)

- Sales Tax (less volatile)
- Individual Income Tax (very volatile)
- Corporate Income Tax (most volatile; worth the trouble?)
- Property Tax (least volatile)

State Sales Tax Collections

1990 – 2002

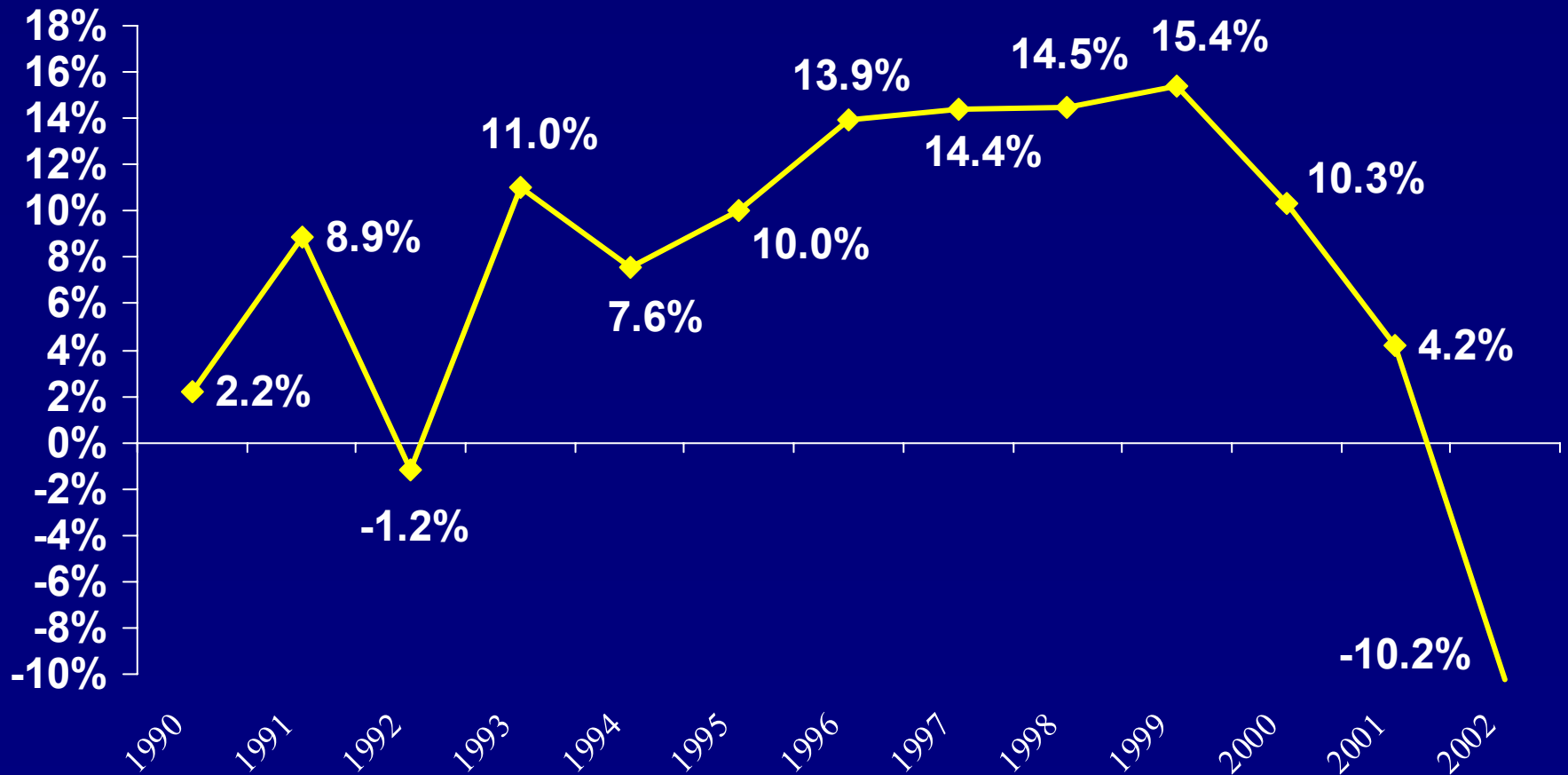
Source: JLBC



Individual Income Tax Collections

1990 – 2002

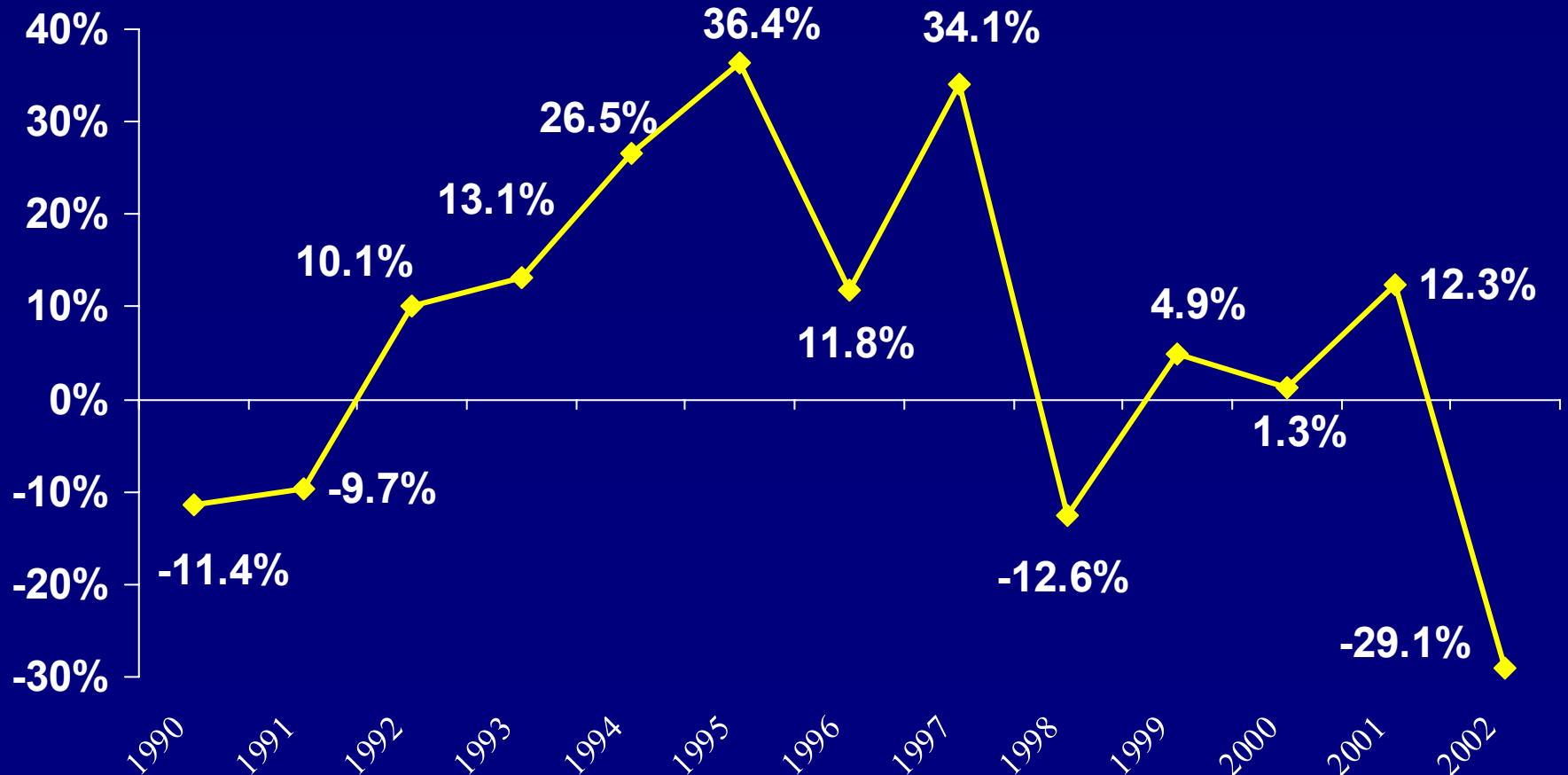
Source: JLBC



Corporate Income Tax Collections

1990 – 2002

Source: JLBC



Who Taxes Property?

Property Taxes Levied in 2001:

State – 0%

Counties – 19.9%

Cities – 7.5%

School Districts – 57.2%

Special Districts – 5.4%

Community Colleges – 9.6%

**Businesses evaluate both
the State and Local tax
code...**

**...therefore we have to
consider the tax system
as a whole.**

From the State's Perspective in FY 1999

- 28.0 from federal transfers.
- 57.7% from taxes.
 - 56.9% from sales taxes.
 - 27.8% from personal income taxes.
 - 3.6% from property taxes.
 - 7.2% from corporate taxes.
 - 4.5% from motor vehicle & other taxes.
- 14.3% from charges like tuition, interest, etc.

From the local perspective

- 35.9% in transfers from the state.
- 29.2% from taxes.
 - 70.6% from property taxes.
 - 25.0% from sales taxes.
 - 4.4% from others, mostly vehicle taxes.
- 18.0% from charges like tuition, sewer & trash.
- 15.6% from utilities like water & electricity.
- 1.3% from various others.

Where does the state spend its money?

- 41.6% is transferred to cities/counties.
- 12.9% for education, mostly universities & CCs.
- 14.3% for social services, like DES & AHCCCS.
- 7.9% for UI, Workers Comp & retirement.
- 8% for transportation, like highways & airports.
- 6.3% for public safety, like corrections & DPS.
- 3.9% for administration & debt service.
- 1.6% for natural resources like parks.

Where do local officials spend their money?

- 35.5% for education.
- 5.6% for social services and health.
- 6.2% for transportation.
- 9.6% for public safety.
- 9.6% for environmental.
- 15.2% for admin. & debt.
- 15.7% for utility purchase.

**The economy
is cyclical...**

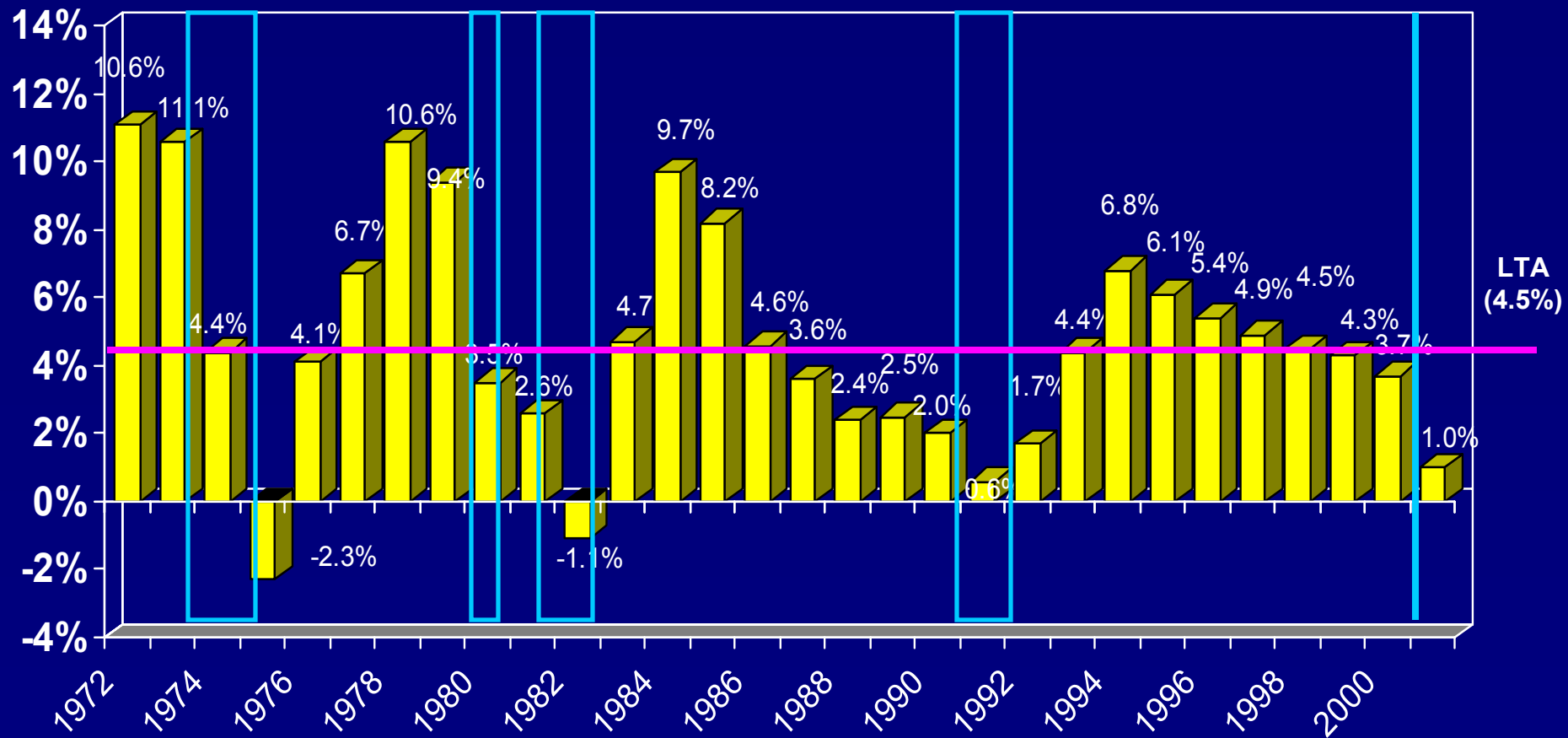
We cannot have a
tax structure that is
not cyclical.

**When things are good, it's
hard to anticipate
downturns, but at least try.**

Arizona Employment*

Annual Percent Change 1972–2001

Source: Arizona Department of Economic Security

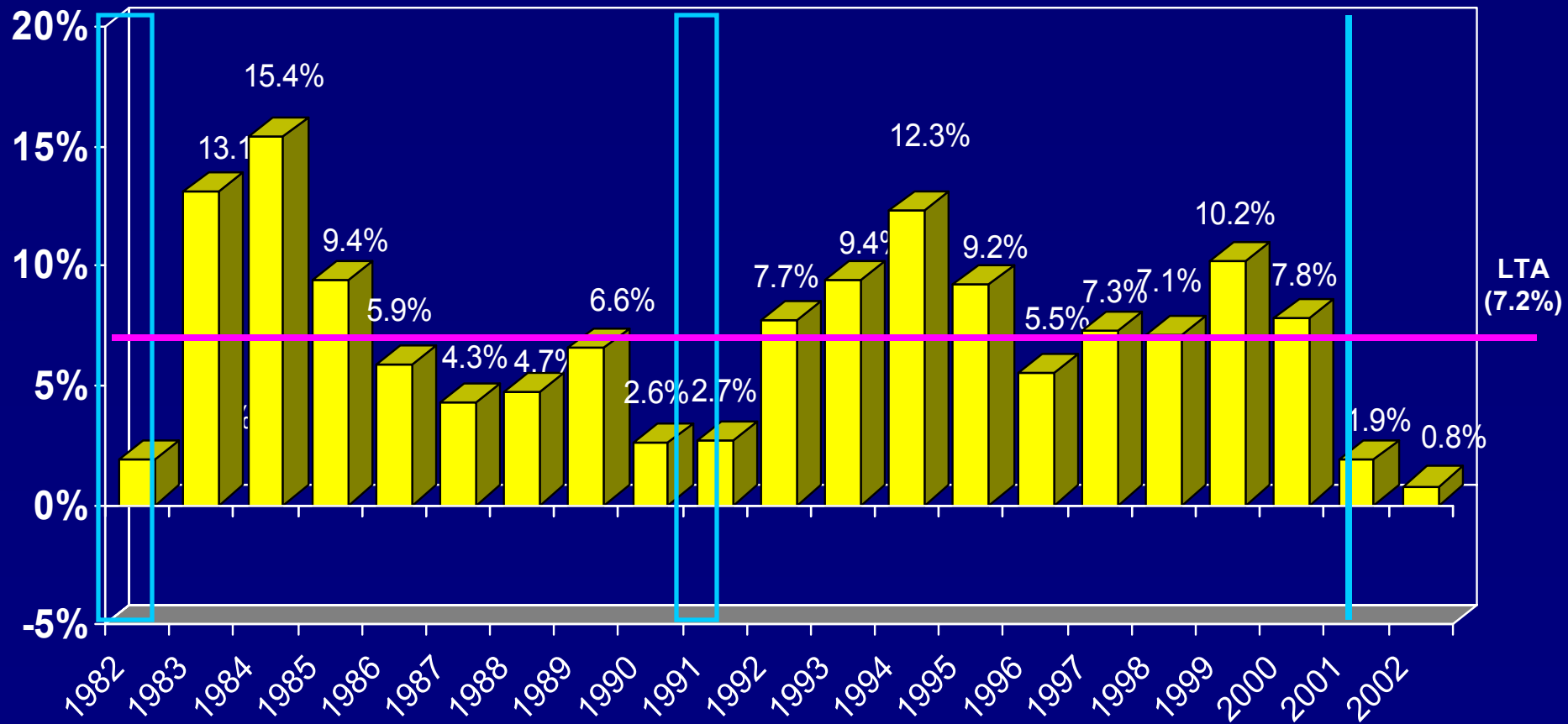


*Non-agricultural wage & salary employment

□ = National recessions

Arizona Retail Sales Annual Percent Change 1982–2002**

Source: Arizona Department of Revenue



** Year-to-date through March 2002

□ = National recessions

STATE'S CURRENT PROBLEMS

- 1. Failure to fully anticipate the recession.**
- 2. Inadequate Budget Stabilization Fund (i.e. rainy day fund).**
- 3. Legislative spending policy?**

There is always going
to be a problem in a
recession...

**BUDGET STABILIZATION
FUND**

The Budget Stabilization Fund needs to be much larger than it has been and should not be touched (not even for another “Alternative Fuel” type of a problem).

FEDERAL MANDATES AND PROPOSITIONS

- **Tied the hands of State government**
- **Much of the budget is uncontrollable.**

GOVERNOR'S CONSTRAINTS

62% of the budget is insulated.

POLITICS

Elections every 2 years make it difficult for politicians to make tough decisions about spending and tax levels.

**In the future, hopefully the
Legislature will recognize
that recessions are
inevitable and significantly
slow the flow of revenues,
and that “rainy day” funds
are necessary.**

Prop. 108

While a supermajority is necessary to raise State taxes, costs can easily be shifted to the local governments, thus requiring an increase in local taxation.

TAX POLICY DEVELOPMENT

**We need to determine what
would help the State reach
its objectives?**

CONCLUSION

All companies are not the same in terms of their impact on the economy.

CONCLUSION

Businesses that can leave, especially in high-paying industries, need to be thought of differently than other companies.

CONCLUSION

**Everybody benefits by
stimulating export-
related companies.**

CONCLUSION

7-Eleven isn't going to leave, but the high-tech company that creates the demand for the 7-Eleven stores, might leave.

CONCLUSION

If the State is going to have a tax and fiscal policy, it should aim it where it does the most good and not be too extreme in any one direction.

CONCLUSION

The way the process is currently structured, when the long term growth rates slow, Arizona will have dug itself into a deep hole.

CONCLUSION

**Tax
consumption
rather than
income**

CONCLUSION

**Tax
consumption
rather than
capital**

CONCLUSION

**Goal is to be
“middle of the pack”**



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